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C O R R E C T E D C O P Y (TEXT--PARA ONE LINE SIX)

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FOR WHITE HOUSE FOR CEA CHAIRMAN SCHULTZE AND SHAFER

PASS: TREASURY FOR WIDMAN; FRB FOR ETTIN; DEPARTMENT
FOR EUR/RPE

E.O. 11652: GDS
TAGS: OECD, ECON, EFIN
SUBJECT: OECD ECONOMIC POLICY COMMITTEE -- REPORT ON
FEBRUARY 27-28 MEETING AND FEBRUARY 27 RESTRICTED BUREAU

REF: (A) PARIS 7428; (B) PARIS 6120; (C) PARIS 6190

1. SUMMARY: AFTER ELECTING CEA CHAIRMAN SCHULTZE TO
BE ITS CHAIRMAN AND SIR DOUGLAS WASS OF UK TO BE ITS
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VICE CHAIRMAN, THE ECONOMIC POLICY COMMITTEE DEVOTED
BULK OF MEETING TO DISCUSSION OF CURRENT CONSTRAINTS
ON FASTER ECONOMIC GROWTH. EPC CONCLUDED THAT THE
EXISTING SITUATION BOTH PERMITS AND REQUIRES A
CONCERTED ACTION STRATEGY TO RAISE OECD AREA-WIDE GROWTH
RATE. ACTIONS UNDER THIS STRATEGY WOULD BE DIFFERENTI-
ATED BY THE EXTERNAL AND INTERNAL SITUATIONS OF EACH

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COUNTRY; I.E., REQUIRING GREATEST EXPANSION BY THOSE IN THE STRONGEST POSITION WHILE RECOGNIZING INTERNAL STABILIZATION REQUIREMENTS OF SOME COUNTRIES WOULD NOT ALLOW ANY GROWTH STIMULATION. STABILIZATION POLICIES AND THE FIGHT AGAINST INFLATION WOULD CONTINUE TO BE PRIORITY ELEMENTS OF THE STRATEGY, BUT MODERATELY FASTER GROWTH WOULD BE ATTEMPTED TO THE EXTENT THAT CONSTRAINTS WERE EASED. NATIONAL GROWTH OBJECTIVES AND FORECASTS WERE NOT SUBJECTED TO IN-DEPTH ANALYSIS AT THIS MEETING, ALTHOUGH SEVERAL COUNTRIES QUESTIONED THE ADEQUACY OF GERMAN AND JAPANESE MEASURES TO MEET THEIR TARGETS (BUT THERE WAS LITTLE, OR NO, QUESTIONING OF THE TARGETS THEMSELVES, EXCEPT PERHAPS BY THE SECRETARIAT IN PRIVATE DISCUSSIONS). SEVERAL DELEGATES (NOTABLY SWISS AND GERMANS) ARGUED THAT CONCERTED ACTION MUST BE SUPPLEMENTED BY U.S. MEASURES TO SUPPORT DOLLAR IN EXCHANGE MARKETS, IF IT IS TO BE SUCCESSFUL. IN THE CONTEXT OF CURRENT SLOW GROWTH, EPC DISCUSSED THE TREND TO PROLIFERATION OF GOVERNMENTAL INTERVENTIONIST MEASURES IN THE ECONOMY, SUCH AS VARIOUS MEASURES TO SUPPORT EMPLOYMENT. THE SECRETARIAT WAS ENCOURAGED TO CONTINUE ITS WORK IN THIS AREA, ESPECIALLY TO DOCUMENT EXTENT OF THESE PRACTICES AND TO DEFINE THE PROBLEM WITH GREATER PRECISION. REPORT ON CHAIRMAN'S SUMMARY CONCLUSIONS SENT SEPTEL (REF. A). NEXT EPC MEETING, MAY 29-30, WILL INCLUDE DISCUSSION OF PREPARATION FOR OECD MINISTERIAL MEETING
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JUNE 14-15. END SUMMARY

CONCERTED ACTION AND CONSTRAINTS

2. DRAWING HEAVILY ON THE SECRETARIAT'S DOCUMENTATION (CPE(78)2 AND PART I OF CPE(78)3), THE EPC UNDERTOOK A DISCUSSION OF PRESENT CONSTRAINTS TO ECONOMIC GROWTH AND THE FEASIBILITY OF EASING SOME OF THEM BY A CONCERTED EFFORT OF OECD MEMBER COUNTRIES, WITH THE ROLE OF EACH DETERMINED BY ITS OWN ROOM FOR MANEUVER. IN THE DISCUSSION, THE CONCEPTS OF CONSTRAINTS AND OF CONCERTED ACTION WERE CLOSELY INTERWOVEN. UNDERLYING THE DISCUSSION WAS THE UNANIMOUSLY ACCEPTED PROPOSITION THAT FASTER GROWTH FOR THE OECD AREA, AS A WHOLE, THAN PRESENTLY PROJECTED IS DESIRABLE, WITH THE CAVEAT THAT THE RATE OF INFLATION SHOULD NOT BE THEREBY ACCELERATED AND THAT FACTOR SHARE IMBALANCES SHOULD CONTINUE TO BE EASED. MANY DELEGATES FELT THAT FASTER GROWTH DID NOT NECESSARILY MEAN 5 PERCENT; IN FACT, THE IDEA OF QUANTITATIVE TARGETS, ESPECIALLY IF NOT MET, WAS DESCRIBED AS COUNTER-PRODUCTIVE AND HARMFUL TO PRIVATE SECTOR EXPECTATIONS. SEVERAL DELEGATES (E.G., U.S., FRG, FRANCE)

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STATED THAT WITHOUT NECESSARILY ACCEPTING THE PRECISE NUMERICAL VALUES, THE SECRETARIAT'S SIMULATION OF CONCERTED ACTION (DOCUMENT CPE(78)3) WAS A USEFUL ILLUSTRATION, AND REMINDER, OF THE SELF-REINFORCING EFFECT OF A WIDESPREAD STIMULUS TO GROWTH. (PREDICTABLY FRG REP TIETMEYER FELT THAT THE ELASTICITIES AND MULTIPLIERS OVERSTATED LIKELY RESULTS.)

3. THE DISCUSSION FAVORING CONCERTED ACTION IMPLICITLY DISCARDED "LOCOMOTIVE" THEORY, EITHER BECAUSE IT WAS FELT BY SOME TO BE IMPRACTICAL OR BECAUSE RECENT DEVELOPMENTS (SLOWER THAN FORECASTED GROWTH AND PROGRESS IN COMBATTING INFLATION) HAVE ENLARGED SCOPE FOR STIMULATORY ACTION TO LARGER GROUP OF COUNTRIES. DESPITE VIRTUALLY UNANIMOUS AGREEMENT (STONE OF AUSTRALIA DISSENTING) THAT "CONCERTED ACTION" WAS A DESIRABLE STRATEGY, THE EPC DID NOT GO MUCH BEYOND CONCEPTUALIZING IT. THIS PROMPTED SEVERAL DELEGATES (E.G., SWEDEN, NORWAY) TO
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ASK HOW CONCERTED ACTION WOULD BEGIN; E.G., WHO DOES WHAT? WHEN? HOW WOULD COMMITMENTS AND PROGRESS BE MONITORED? AND SUGGESTED THAT FUTURE SECRETARIAT WORK PROPOSE SPECIFIC RULES TO BE PLAYED BY EACH COUNTRY. MOST SPEAKERS, AS NOTED BY CHAIRMAN SCHULTZE IN HIS SUMMARY, FELT THAT "CONCERTED ACTION" STILL REQUIRED THOSE COUNTRIES WITH STRONG INTERNAL AND EXTERNAL POSITIONS (I.E., MINIMAL BINDING CONSTRAINTS) TO MOVE FIRST AND FASTEST. BUT OTHER COUNTRIES (I.E., THE "CONVALESCENT ECONOMIES" -- A TERM COINED BY DE LAROSIERE) COULD ALSO MOVE SOMEWHAT FASTER DUE TO IMPROVEMENTS IN THEIR CIRCUMSTANCES AND AS REMAINING CONSTRAINTS ARE EASED BY ACTION OF THE STRONGER ECONOMIES. WITHIN THIS CONTEXT, SEVERAL DELEGATES (FIRST SWITZERLAND, BUT ALSO FRG, NETHERLANDS, BELGIUM, AND UK) SUGGESTED THAT U.S. ROLE IN "CONCERTED ACTION" SHOULD BE STEPS TO STABILIZE THE EXCHANGE MARKETS THROUGH COORDINATED INTERVENTION, INCLUDING MORE ACTIVE U.S. ROLE IN "FINANCING THE U.S. CURRENT ACCOUNT DEFICIT" (SEE ALSO PARA.10 BELOW). ENACTMENT OF A U.S. ENERGY PROGRAM WAS ALSO CITED AS A KEY FACTOR FOR STABILIZING THE EXCHANGE MARKETS. (FYI -- AT THE RESTRICTED BUREAU DINNER FEBRUARY 27, IT WAS AGREED THAT PROPONENTS OF THIS "PACKAGE DEAL" OF U.S. SUPPORT FOR THE DOLLAR IN EXCHANGE FOR GREATER EUROPEAN EXPANSION WOULD NOT PRESS FOR HAVING IT MENTIONED IN THE CONCLUSIONS OF THE MEETING. END FYI) SOME DELEGATES (ESPECIALLY SCANDINAVIANS), OVERCOME BY PESSIMISM, ASKED SECRETARIAT TO PRODUCE ANALYSIS OF CONSEQUENCES OF A "NO GROWTH" SCENARIO AS ANTIDOTE FOR THOSE HESITANT TO JOIN THE CONCERTED ACTION STRATEGY.

4. MOST SPEAKERS INDICATED THAT MAIN RATIONALE FOR CONCERTED ACTION LIES IN ITS EASING OF CONSTRAINTS FOR CONFIDENTIAL

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ALL PARTICIPANTS: POLITICAL AND PSYCHOLOGICAL CONSTRAINTS FOR THE STRONG; BALANCE OF PAYMENTS AND INFLATION CONSTRAINTS FOR THE CONVALESCING; BALANCE OF PAYMENTS CONSTRAINT FOR THE WEAK; A BETTER ENVIRONMENT FOR INVESTMENT AND STRUCTURAL ADJUSTMENT FOR ALL. MOST DELEGATES ALSO FELT THAT THE INFLATION CONSTRAINT HAD EASED SIGNIFICANTLY SINCE LAST SPRING AND THAT THIS WAS THE PRINCIPAL AREA OF IMPROVEMENT IN THE GLOBAL ECONOMIC PICTURE. SOME, HOWEVER, E.G., SPAIN, PORTUGAL, SAID THEY WERE STILL NOT IN POSITION TO TAKE EXPANSIONARY ACTION DUE TO CONTINUED HIGH INFLATION. SOME COUNTRIES SAW THE BOP DEFICIT AS THEIR MAIN CONSTRAINT -- E.G.,

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FRANCE, AUSTRIA, NORWAY -- WHILE ACCORDING TO OTHERS, THEIR CURRENT ACCOUNT SURPLUS WAS PUTTING UPWARD PRESSURE ON THEIR CURRENCY, THUS ENDANGERING ECONOMIC EXPANSION. SEVERAL DELEGATES, AND THE SECRETARIAT (MARRIS), FELT THAT THE BOP CONSTRAINT CONSISTS NOT SIMPLY OF DEFICITS AS SUCH (AND ACCUMULATED DEBT, THUS HIGHER DEBT SERVICING WHICH MAY HURT FUTURE GROWTH) BUT OF THE MALDISTRIBUTION OF PAYMENTS POSITIONS (SINCE A FEW SURPLUS COUNTRY "HAVENS" EXIST TO RECEIVE CAPITAL OUTFLOWS FROM DEFICIT COUNTRIES). THUS THIS MALDISTRIBUTION FEEDS EXCHANGE MARKET INSTABILITY AND REDUCES CONSUMER AND INVESTOR CONFIDENCE. WITH REGARD TO THE SURPLUS COUNTRIES, THERE WAS A WIDESPREAD SENSE OF SKEPTICISM AS TO THE REAL IMPORTANCE OF THE POLITICAL ADMINISTRATIVE, PSYCHOLOGICAL AND CONSTITUTIONAL CONSTRAINTS CITED BY THEM -- PARTICULARLY IN THE EVENT THAT THESE

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GOVERNMENTS CAME UNDER PRESSURE TO EXPAND FOR DOMESTIC, RATHER THAN INTERNATIONAL, REASONS.

COUNTRY STATEMENTS (IN ORDER OF SPEAKING)

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5. GERMANY: TIETMEYER (ASSISTANT SECRETARY, MINISTRY OF ECONOMICS) REVIEWED 1977 GERMAN ECONOMIC PERFORMANCE, NOTING THAT IT HAD NOT BEEN AS STRONG AS EXPECTED, BUT THAT CLEAR SIGNS OF A DOMESTIC DEMAND RECOVERY WERE EVIDENT IN THE FOURTH QUARTER. ACCORDING TO TIETMEYER, WHILE THERE ARE SIGNS, MORE PROMISING THAN EXPECTED, WHICH ENCOURAGE THE GERMAN AUTHORITIES THAT THE 3-1/2 PERCENT GROWTH OBJECTIVE (I.E., A 4-1/2 - 5 PERCENT GROWTH PATH OVER THE YEAR) WOULD BE MET, THERE ARE REAL DANGERS IN THE FORM OF FURTHER EXCHANGE RATE APPRECIATION AND EXCESSIVE WAGE SETTLEMENTS (ABOVE 5.5 PERCENT) WHICH COULD THREATEN THIS OBJECTIVE. (FYI: HE WOULD NOT SPECULATE, WITHIN THE EPC PLENARY, ON WHAT WOULD
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HAPPEN IF INDICATORS TURNED DOWN -- BUT DID SAY PRIVATELY TO SCHULTZE AT BUREAU DINNER THAT HE WAS WORKING WITHIN FRG TO PROMOTE NEW STIMULATIVE MEASURES AND THAT HE HOPED SOMETHING MIGHT DEVELOP IN MAY. END FYI) TIETMEYER AGAIN, AS IN NOVEMBER, REJECTED HIGHER WAGE SETTLEMENTS AS A PATH TO RECOVERY THROUGH PRIVATE CONSUMPTION -- ARGUING THAT COST INCREASES WERE TRANSMITTED FASTER THAN DEMAND INCREASES, THUS THE LOSS IN INVESTMENT, DUE TO WEAKENED PROFITS AND CONFIDENCE, WOULD BE GREATER THAN THE RISE IN CONSUMPTION. FRG DELS (TIETMEYER AND SCHULMANN) CITED FOUR CONSTRAINTS TO FASTER GERMAN GROWTH: (1) LACK OF POLITICAL CONSENSUS THAT FURTHER STIMULUS IS DESIRABLE OR WOULD BE EFFECTIVE; (2) FEDERALIST SYSTEM DID NOT PERMIT QUICK IMPLEMENTATION OF CERTAIN PUBLIC INVESTMENT PROGRAMS, E.G., THE ENERGY CONSERVATION PROGRAM; (3) CONSTITUTIONAL LIMIT ON GOVERNMENT DEFICITS WHICH IS NOW BEING REACHED; AND (4) RESTRAINING INFLUENCE OF FRG MEMBERSHIP IN THE EC, WHICH MEANS GERMANY CANNOT, EVEN IF IT WISHES, "GO IT ALONE." TIETMEYER CLOSED HIS FORMAL STATEMENT BY CITING SECRETARY BLUMENTHAL AS HAVING TOLD A PRESS CONFERENCE THAT GERMAN ECONOMIC PERFORMANCE FOR 1978 IS "SATISFYING." PRIOR TO GERMAN INTERVENTION, SECRETARIAT (FAY) REVISED ITS 1978 FORECAST FOR GERMANY BACK FROM 2-3/4 PERCENT IN EPC DOCUMENTATION TO 3-1/4 PERCENT YEAR ON YEAR (AS IN ECONOMIC OUTLOOK NO. 22) AS RESULT OF STRONGER THAN EXPECTED CARRYOVER FROM FOURTH QUARTER OF 1977.

6. FRANCE: CORTESSE (DIRECTOR, PLANNING) AND DE LAROSIERE (DIRECTOR OF THE TREASURY) REPORTED THAT RECENT POSITIVE DEVELOPMENT OUTWEIGHED NEGATIVE -- BUT THAT FRANCE WAS TIGHTLY CONSTRAINED BY ITS EXTERNAL
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ACCOUNT DUE TO ITS HIGH INCOME ELASTICITY FOR IMPORTS. FRENCH EXTERNAL CONSTRAINT DUE NOT ONLY TO POSSIBLE DEFICIT ON CURRENT ACCOUNT, BUT ALSO DEFICIT ON CAPITAL ACCOUNT DUE TO (A) SHARP INCREASE IN LONG-TERM EXPORT FINANCING TO EAST AND LDC'S AND (B) SUBSTANTIALLY REDUCED GROSS INFLOW OF FOREIGN DIRECT AND PORTFOLIO INVESTMENT. FRENCH EXTERNAL DEBT, BOTH FROM LARGE DEFICITS IN MID-70'S, AND MORE RECENT CURRENT AND CAPITAL DEFICITS, HAS GROWN RAPIDLY AND IS CONSTRAINING. THE INFLATION SITUATION IS ALSO EXTREMELY FRAGILE UNLESS EXPANSION COMES FROM INVESTMENT (THUS RAISING PRODUCTIVITY) OF EXPORTS (THUS EASING EXTERNAL CONSTRAINT). DUE "WAITING ATTITUDE" ASSOCIATED WITH ELECTIONS, INVESTMENT STAGNATING. DUE NON-OIL LDC AND EASTERN DEFICITS AND OPEC "SATURATION," EXPORT DEMAND WOULD HAVE TO COME FROM MAJOR OECD PARTNERS. DE LAROSIERE CONTRIBUTED A CLEAR AND WELL-STRUCTURED OUTLINE OF THE NEED FOR "CONCERTED ACTION" STRESSING THE CRITICAL NATURE OF THE EXTERNAL CONSTRAINT TO SEVERAL COUNTRIES (I.E., THE CONVALESCENT ECONOMIES). HE ADDED THAT THE CLIMATE OF EXPECTATIONS WAS NOT HELPED BY THE PROLIFERATION OF STATEMENTS (READ GERMANS) ALONG THE LINES, "WE HAVE DONE WHAT WE CAN DO, AND MUST JUST WAIT TO SEE WHAT HAPPENS" -- ARGUING THAT THE DOOR SHOULD ALWAYS BE LEFT SLIGHTLY AJAR, ADMITTING THE POSSIBILITY OF SOME FORWARD MOVEMENT.

7. JAPAN: TANAKA (DEPUTY DIRECTOR, COORDINATION, EPA)

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STATED THAT THE PROPOSED 15-MONTH BUDGET WAS DESIGNED TO GIVE A CONTINUOUS STIMULUS TO THE ECONOMY AND THEREBY CHANGE THE PSYCHOLOGY OF THE PRIVATE SECTOR, BOTH CONSUMERS AND INVESTORS. HE CITED "HIDDEN UNEMPLOYMENT" AS A SERIOUS PROBLEM IN JAPAN WHICH IS STIFLING PRODUCTIVITY AND INVESTMENT. THE 30 PERCENT FINANCING HURDLE HAD BEEN CLEARED -- BUT DEFICIT FINANCING WAS NOT LIMITLESS, THUS THE 7 PERCENT GROWTH TARGET SET FOR FY78 WAS "THE HIGHEST POSSIBLE TARGET." MATSUKAWA (MINISTER FINANCE) CLAIMED THAT THE PROJECTED GOVERNMENT DEFICIT WOULD IN EFFECT ABSORB THE TOTAL SAVINGS OF THE HOUSEHOLD SECTOR. ON THE BALANCE OF PAYMENTS, MATSUKAWA NOTED THAT EXPORT VOLUME HAD INCREASED ONLY 3 PERCENT IN 1977 (VS. 6 PERCENT EXPECTED) AND THAT IMPORT VOLUME WAS UP ONLY 3.4 PERCENT (VS. 9 PERCENT EXPECTED), THUS PRINCIPAL CONTRIBUTOR TO INCREASED 1977 TRADE SURPLUS WAS CONFIDENTIAL

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PRICE EFFECTS OF YEN APPRECIATION. FOR 1978, EXPORT VOLUME WOULD BE UP 3 PERCENT AGAIN, BUT EFFECTS OF YEN APPRECIATION WILL BEGIN TO HAVE EFFECT AT END OF 1978. IMPORT VOLUME SHOULD RISE SIGNIFICANTLY (7 PERCENT) AS PRODUCTION RECOVERS AND STOCKS ARE ACCUMULATED. MATSUKAWA STATED THAT THESE PROJECTIONS LEFT A $6 BILLION TRADE SURPLUS -- BUT ADDED THAT LARGE SURPLUS CANNOT BE ELIMINATED IN SHORT-TERM, WHILE REITERATING GOJ PHILOSOPHY THAT LARGE, REPEAT LARGE, CURRENT SURPLUS NOT DESIRABLE NOR SUSTAINABLE.

8. UNITED STATES: CHAIRMAN SCHULTZE RELINQUISHED THE CHAIR TO THE SECRETARY-GENERAL BEFORE THE U.S. INTERVENTION. HE CHARACTERIZED THE U.S. ECONOMY AS HAVING SUFFICIENT UNDERLYING STRENGTH TO MEET THE GOVERNMENT'S 4-3/4 - 5 PERCENT GROWTH OBJECTIVE FOR 1978 AND 1979 WITHOUT FURTHER POLICY STIMULUS. THE BUDGET FOR FY1979 THEREFORE PROVIDES TAX REDUCTIONS LARGE ENOUGH ONLY TO OFFSET HIGHER SOCIAL SECURITY TAX COLLECTIONS AND FIS-

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CAL DRAG THROUGH 1979. THE ADMINISTRATION'S FISCAL POLICY PHILOSOPHY IS, SCHULTZE ADDED, TO LIMIT GOVERNMENT SPENDING TO PRESENT LEVELS (REDUCING THE PUBLIC SECTOR PERCENTAGE OF GNP OVER TIME) AND USE TAX ADJUSTMENTS AS THE INSTRUMENT OF FISCAL POLICY. IN THE PRESENT CASE, I.E., INVESTMENT SLUGGISHNESS (DESPITE PROFITABILITY, ADJUSTED TO NORMAL CAPACITY UTILIZATION, NOW AT POST-WAR AVERAGE) HAS PROMPTED THE ADMINISTRATION TO PROPOSE A MAJOR BUSINESS TAX CUT AS PART OF THE TAX PACKAGE -- THEREBY ATTEMPTING TO INCREASE INVESTMENT (FROM 4-1/2 PERCENT PLANNED IN 1978 ACCORDING TO RECENT SURVEY TO 6-1/2 - 7 PERCENT) AOZG OID#SECTORAL BOTTLENECKS AND CAPITAL SHORTAGES AS THE RECOVERY CONTINUES.
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9. HIGHER STRUCTURAL UNEMPLOYMENT (PARTICULARLY MINORITIES AND YOUTH) RESULTED IN A DOUBLING OF FUNDS FOR TRAINING AND EMPLOYMENT SUBSIDIES IN THE FY78 FEDERAL BUDGET. INFLATION IS PERSISTENT BUT NOT LIKELY TO ACCELERATE AT CURRENT GROWTH RATES, NOR SLOW SUBSTANTIALLY WITH SLOWER GROWTH. THE CHALLENGE, SCHULTZE NOTED, WAS TO BOOST GROWTH WITHOUT ACCELERATING INFLATION -- A TASK THE ADMINISTRATION HOPED TO ACCOMPLISH BY USING TAX CUTS RATHER THAN EXPENDITURE INCREASES, CREATING STOCKPILES OF KEY RAW MATERIALS, AND ANTICIPATING STRUCTURAL/SECTORAL BOTTLENECKS. THE UNDERLYING RATE (NOW STUCK AT 6 PERCENT) WOULD REQUIRE OTHER POLICY TOOLS -- VIZ. VOLUNTARY DECENTRALIZED WAGE GUIDELINES, WHICH WERE IN EFFECT A LOOSE INCOMES POLICY INSTRUMENT.

10. ON THE BALANCE OF PAYMENTS, WIDMAN (TREASURY) POINTED OUT THAT THE GLOBAL BOP SITUATION WAS IMPROVING, BUT THAT THE U.S. DEFICIT, ALTHOUGH SMALL AS A PERCENTAGE OF GNP, WAS LARGE, ABSOLUTELY, DUE PRINCIPALLY TO (A) DIFFERENTIAL GROWTH PERFORMANCE OF U.S. AND EUROPE/JAPAN (I.E., U.S. EXPORTS WOULD BE $10 BILLION HIGHER IF MAJOR PARTNERS HAD BEEN GROWING AT 4 PERCENT ANNUALLY); (B) SOME LOSS OF COMPETITIVE POSITION IN 1974/75 SHOWING UP IN 1976/77; AND (C) ENERGY (OIL) IMPORTS. NEVERTHELESS, U.S. DEFICIT APPEARS, CLEARLY, TO HAVE "BOTTOMED OUT" AND POSITIVE SWING UNDERWAY. WIDMAN ADDED THAT THEU.S. HAD NO INTENTION TOSLOW ITS GROWTH, USE PROTECTIONIST MEASURES, INVOKE CAPITAL CONTROLS OR UNDERTAKE SPECIAL FINANCING, EITHER

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OFFICIAL OR PRIVATE. LATTER WOULD, IN U.S. VIEW, BE FUTILE GIVEN FUNGIBLE MARKETS AND WORLDWIDE HOLDING OF VARIOUS U.S. DOLLAR ASSETS. SUCH ACTION WOULD HAVE UNPREDICTABLE EFFECTS NOT ONLY ON EXISTING DOLLAR HOLDINGS, BUT ALSO ON COUNTRIES IN WHOSE CURRENCIES PROPOSED BONDS WOULD BE DENOMINATED. NEVERTHELESS, WHILE U.S. WILL NOT DEFEND ANY SPECIFIC RATE, WE WILL DO EVERYTHING NECESSARY TO COMBAT DISORDERLY CONDITIONS IN FOREIGN EXCHANGE MARKETS. IN THE VIEW OF THE U.S., MARKETS ARE CURRENTLY OVERWHELMED BY DOWNSIDE EXPECTATIONS WHICH WILL EVENTUALLY BE REVERSED, AT WHICH POINT UNDERLYING FUNDAMENTALS, INCLUDING INTEREST RATE DIFFERENTIALS WILL GOVERN.

11. ETTIN (FRB) NOTED THAT U.S. INTEREST RATES HAD RISEN SUBSTANTIALLY DURING 1977 AND WERE NOW NEAR THE LEVEL AT WHICH SIGNIFICANT DISINTERMEDIATION WOULD OCCUR. THIS WOULD HAVE MAJOR REPERCUSSIONS THROUGHOUT
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THE FINANCIAL MARKETS, IMPACTING NOT ONLY ON MORTGAGES, WHICH ARE ALREADY BEING SQUEEZED, BUT ON ENTIRE LONGER

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END OF INTEREST RATE STRUCTURE. SCHULTZE ADDED THAT INTEREST RATES DIFFERENTIALS WERE ALREADY WIDE -- AND THAT FURTHER WIDENING COULD BETTER OCCUR THROUGH LOWERING OF RATES ABROAD RATHER THAN INCREASING U.S. RATES.

12. UNITED KINGDOM: WASS (PERMANENT SECRETARY, TREASURY) STRESSED THE NEED FOR FASTER GROWTH (A) TO COUNTERACT THE TREND TO PROTECTIONISM, BOTH OPEN AND CONCEALED, NOTING THE RECENT EXCEPTIONALLY SLOW GROWTH OF WORLD TRADE AS A SYMPTOM OF GREATER PROTECTIONISM ALREADY IN PLACE AND (B) TO ASSURE THAT SUFFICIENT INVESTMENT TAKES PLACE TO MEET FUTURE DEMANDS OF THE POPULATION. CITING THE CASE OF THE UK, WASS WAS SURPRISED THAT UNEMPLOYMENT IS NOT HIGHER THAN IT IS GIVEN THE SLOW GROWTH IN OUTPUT AND DEMAND. HE STRESSED THE PRACTICAL DIFFICULTIES OF PUTTING CONCERTED ACTION INTO OPERATION -- BUT NEVERTHELESS FELT IT TO BE ESSENTIAL TO OVERCOMING THE PREDOMINANT CONSTRAINT OF CURRENT ACCOUNT MALDISTRIBUTION.

SCHULTZE'S STATEMENT ON CONSTRAINTS

13. AT END OF HIS REVIEW OF U.S. POLICY AND OUTLOOK, CHAIRMAN SCHULTZE ANALYZED VARIOUS GROWTH CONSTRAINTS DRAWING ON U.S. EXPERIENCE, BUT ALSO SEEKING TO DRAW SOME GENERAL LESSONS FOR THE EPC DISCUSSION. HIS STATEMENT COVERED THE FOLLOWING MAIN IDEAS:

-- INFLATION: NOT A CONSTRAINT FOR U.S. WITHIN RELEVANT GROWTH-RANGE, BUT IS MAIN FACTOR IN HOLDING GROWTH OBJECTIVE TO ONE PERCENT OVER TREND. THREE-YEAR CON-
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TRACTS AND IMITATIVE BEHAVIOR IN CONTRACT BARGAINING MAKE WAGES SLUGGISH AND LESS SUSCEPTIBLE TO RESTRICTIVE DEMAND MANAGEMENT WITHOUT UNDESIRABLE EFFECTS ON INVESTMENT LEVELS AND FUTURE CAPACITY. THUS RELATIONSHIP OF INFLATION TO AGGREGATE DEMAND IN U.S. MEANS IT DOES NOT PAY TO HOLD GROWTH AT OR BELOW TREND.

-- IMPOTENT INSTRUMENTS: SOME DANGERS EXIST IF FISCAL AND MONETARY INSTRUMENTS ARE MISUSED, OR GOVERNMENTS ARE TOO WEAK TO REVERSE TRENDS IF SO REQUIRED. LONGER-RUN EFFECTS OF INSTRUMENT MUST BE TAKEN INTO ACCOUNT WHEN USING IT FOR SHORT RUN EFFECT, PARTICULARLY TO AVOID INDUCING FUTURE INFLATIONARY RESPONSE. LEADERS MUST NOT ONLY PLAN USE OF INSTRUMENTS, BUT MUST CONVINCE PRIVATE SECTOR THAT POLICY INSTRUMENTS ARE NOT INHERENTLY DANGEROUS AND INFLATIONARY.

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-- EXTERNAL CONSTRAINT ON INVESTMENT: NOT REALLY A PROBLEM FOR U.S. DUE TO LARGE DOMESTIC MARKET, BUT A KEY FACTOR FOR COUNTRIES WITH SMALLER DOMESTIC MARKETS WHICH WOULD BE HIGHLY SENSITIVE TO CONCERTED ACTION, INCREASING CAPACITY UTILIZATION AND PROFITABILITY IN EXTERNAL IN ADDITION TO INTERNAL MARKETS.

-- FACTOR SHARE IMBALANCES: NOT A MAJOR PROBLEM IN U.S. BASED ON POST-WAR TRENDS, IF CONSIDER PROFIT SHARE ADJUSTED FOR CAPACITY UTILIZATION (WHICH IS VITAL CON-

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SIDERATION IN DETERMINING APPROPRIATE POLICY). WHERE FACTOR SHARE IMBALANCE IS A PROBLEM SOME PROGRESS SEEMS TO HAVE BEEN MADE, BUT THERE MAY BE PARTICULAR ROLE FOR INCOMES POLICY AND POLITICAL COURAGE.

-- SECTORAL PROBLEMS: NUMEROUS TYPES CAUSED, E.G., BY CHANGING DEMAND PATTERNS, RELATIVE PRICES AND TRADE FLOWS, AND SHIFTS TO SERVICES OR LOWER CAPITAL-USING SECTORS -- BUT THESE SHIFTS HAVE BEEN GOING ON FOR A LONG TIME. THERE IS NO EVIDENCE IN TERMS OF DISPERSION OF CAPACITY UTILIZATION RATES THAT

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THEY HAVE ACCELERATED ENOUGH TO REQUIRE MAJOR RESOURCE REALLOCATION WHICH WOULD SLOW GROWTH. SCOPE AND UNCERTAINTY OF NEW GOVERNMENT REGULATIONS IN THE AREAS OF ENVIRONMENT, WORKER SAFETY, ETC. MAY BE HAVING NEGATIVE IMPACT ON BUSINESS CONFIDENCE, THUS HURTING INVESTMENTS, AT THE MARGIN.

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-- STRUCTURAL UNEMPLOYMENT: MOST U.S. UNEMPLOYMENT IS CYCLICAL, BUT STRUCTURAL UNEMPLOYMENT IS A MAJOR PROBLEM FOR THE U.S. SINCE IT IS CONSIDERABLY HIGHER THAN 10 YEARS AGO AND MUST BE TACKLED BEFORE IT IS REACHED, LEST INFLATION STARTS TO ACCELERATE.

-- BALANCE OF PAYMENTS: FOR SEVERAL REASONS, THE GLOBAL LOSSES FROM SLOWER U.S. GROWTH (AND LOWER DEFICIT) WOULD OUTWEIGH THE GAINS -- THUS U.S. DOES NOT CONSIDER BALANCE OF PAYMENTS A CONSTRAINT AT PRESENT WITHIN THE RELEVANT RANGE OF GROWTH. PROJECTED DEFICIT SHOULD BE FINANCEABLE WITH STABLE EXPECTATIONAL CONDITIONS. ENERGY IS SPECIAL IN THIS REGARD -- BUT THE ADMINISTRATION IS DETERMINED TO PUT IN PLACE AN EFFECTIVE ENERGY PROGRAM BY LEGISLATION IF POSSIBLE OR EXECUTIVE ACTION IF NECESSARY.

STRUCTURAL ADJUSTMENT AND GOVERNMENT INTERVENTION

14. SECRETARIAT (MARRIS) INTRODUCED THE DISCUSSION OF THIS AGENDA ITEM BY NOTING THAT FASTER GROWTH WILL NOT SOLVE ALL PROBLEMS FACING MEMBER ECONOMIES. SOME OF THE STRUCTURAL IMBALANCES AND GOVERNMENTAL INTERVENTION MEASURES THAT HAVE BEEN TAKEN ARE BECOMING BUILT-IN AND WILL NOT BE REMOVED WITHOUT POSITIVE ACTION. THE SCOPE OF GOVERNMENT INTERVENTION IS NOW MORE DIFFICULT TO IDENTIFY SINCE TRADITIONAL TRADE MEASURES ARE BEING SUPPLEMENTED BY NEW FORMS OF TRADE RESTRICTION (E.G., ORDERLY MARKETING ARRANGEMENTS, TRIGGER PRICES) WHILE BEYOND TRADE MEASURES, GOVERNMENTS ARE TAKING A RANGE OF DOMESTIC STRUCTURAL/SECTORAL ACTIONS WHICH HAVE THE NOMINAL OBJECTIVE OF ASSISTING ADJUSTMENT, BUT HAVE HARMFUL IMPLICATIONS FOR EFFICIENCY OF ECONOMIES. A CONFIDENTIAL

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SECRETARIAT STUDY, IN ITS PRELIMINARY STAGES, IS FINDING THAT THESE GOVERNMENT INTERVENTIONS ARE SIMPLY

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REACTING TO ACUTE EMPLOYMENT PRESSURES RESULTING IN EFFECT IN PROPPING UP THE WEAKEST SECTORS. THIS TREND WILL LEAD TO REDUCED EFFICIENCY, REDUCED TRADE AND BLOCKAGE OF LDC EXPORTS, WITH BOTH DOMESTIC AND INTERNATIONAL IMPLICATIONS. ALL SPEAKERS (ESPECIALLY FRG AND CANADA) WELCOMED THE SECRETARIAT INITIATIVE, URGING THAT THE STUDY CONCENTRATE ON DEFINING THE PROBLEM, IDENTIFYING AND CLASSIFYING MEASURES BOTH TRADITIONAL AND NON-TRADITIONAL, PROVIDING A FRAMEWORK FOR ANALYZING THEIR IMPACT AND SUGGESTING MEANS TO MINIMIZE THE NEGATIVE DOMESTIC AND INTERNATIONAL EFFECTS WHERE ACTION IS INEVITABLE. HIRAHARA (JAPANESE PERMANENT DEL TO OECD) EXPRESSED CONCERN THAT POLICY ACTIONS TAKEN IN THE NAME OF STRUCTURAL ADJUSTMENT WERE ACTUALLY DESIGNED TO AVOID ADJUSTMENT AND PREVENT TRADE EXPANSION. CHAIRMAN SCHULTZE ENCOURAGED SECRETARIAT TO CONTINUE ITS WORK IN THIS AREA, NOTING THAT GOVERNMENTS NEED HELP AT NATIONAL LEVEL TO WIN THE BATTLES, EVEN IF OVERALL VICTORY IN THE WAR SEEMS BEYOND IMMEDIATE REACH. THERE WAS LITTLE SENTIMENT FOR MOVING TO ANY EARLY CONSIDERATION OF AN OECD INTERNATIONAL COMMITMENT ON INTERVENTIONS

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HOWEVER, SOME DELS (FRG) FELT INTERNATIONAL COMMITMENT WOULD BE USEFUL IN HELPING DISCIPLINE NATIONAL ACTION.

OTHER ITEMS

15. REPORT FROM WP-3: CHAIRMAN OF WP-3 (MATSUKAWA) GAVE ORAL REPORT TO EPC ON DISCUSSION AT FEBRUARY 16-17 MEETING OF WP-3. THIS CONSISTED LARGELY OF READING CHAIRMAN'S SUMMARY (PARIS 6190 NOTAL) PARAGRAPHS (1) - (4) OF TEXT.

16. ELECTION OF OFFICERS (SCHULTZE TO BE CHAIRMAN, WASS TO BE VICE CHARIMAN) WENT AS PRE-ARRANGED (REF-TEL B). TIETMEYER NOMINATED THE ENTIRE SLATE, WHICH WAS SECONDED BY SWEDES.

17. NEXT EPC MEETING SCHEDULED FOR MAY 29-30 RATHER
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THAN JUNE 5-6 ORIGINALLY PROPOSED BY SECRETARIAT.
FYI: TO STIMULATE BETTER EXCHANGE OF VIEWS AND MORE USEFUL DISCUSSION, CHAIRMAN SCHULTZE PLANS TO INSTITUTE NEW SCENARIO FOR EPC PLENARY MEETINGS. MISSION WILL WORK WITH SECRETARIAT AND OTHER DELEGATIONS TO DEVISE PROPOSAL WHICH WILL BE FORWARDED SHORTLY. SCHULTZE ALSO BELIEVES THAT EXCEPT FOR UNUSUAL CIRCUMSTANCES, IT IS PREFERABLE TO ELIMINATE WINTER EPC REPLACING IT WITH A BUREAU MEETING. END FYI
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC REPORTS, COMMITTEE MEETINGS, MEETING REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 06 mar 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978PARIS07999
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780147-0374, D780101-0543
Format: TEL
From: PARIS USOECD
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t197803102/aaaadiux.tel
Line Count: 798
Litigation Code IDs:
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Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 7d29f8b7-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 15
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 PARIS 7428, 78 PARIS 6120, 78 PARIS 6190
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 17 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3106364
Secure: OPEN
Status: NATIVE
Subject: OECD ECONOMIC POLICY COMMITTEE -- REPORT ON FEBRUARY 27-28 MEETING AND FEBRUARY 27 RESTRICTED BUREAU
TAGS: ECON, EFIN, OECD
To: STATE
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/7d29f8b7-c288-dd11-92da-001cc4696bcc
Review Markings:
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